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9 *Collector of the County of Santa Barbara,*  
*California; and Santa Barbara County Air*  
*Pollution Control District*

10 UNITED STATES BANKRUPTCY COURT  
11 CENTRAL DISTRICT OF CALIFORNIA  
12 SANTA BARBARA DIVISION

13 In re:

14 HVI Cat Canyon, Inc.,  
15  
16 Debtor.

Case No.: 9:19-bk-11573-MB

Chapter 11

**SANTA BARBARA COUNTY AIR  
POLLUTION CONTROL  
DISTRICT, COUNTY OF SANTA  
BARBARA, AND HARRY E.  
HAGEN, TREASURER-TAX  
COLLECTORS' SUPPLEMENTAL  
RESPONSE TO DEBTOR'S  
MOTIONS REGARDING USE OF  
CASH COLLATERAL**  
(No Hearing Required Unless  
Requested)

Crtm: 303

Judge: Hon. Martin R. Barash

**TO THE HONORABLE MARTIN R. BARASH, UNITED STATES  
BANKRUPTCY JUDGE, AND ALL INTERESTED PARTIES:**

The Santa Barbara County Air Pollution Control District, the County of Santa Barbara, California, and Harry E. Hagen, Treasurer-Tax Collector of the County of Santa Barbara<sup>1</sup> (“S.B. Parties”), supplement their responses to the debtor’s Motion for Interim and Final Orders Pursuant to 11 U.S.C. §§ 105, 361, 362 and 363 Approving Use of Cash Collateral, Providing Adequate Protection and Setting Final Hearing Pursuant to Bankruptcy Rule 4001 [Dkt. 11] and debtor’s Motion to Surcharge Collateral Pursuant to 11 U.S.C. §§ 506(c) and 552(b) [Dkt. 55] (“Motions”) as follows:

**Factual Background**

HVI Cat Canyon, Inc. (the “debtor”) filed its chapter 11 bankruptcy petition on July 25, 2019. It has continued to operate its assets and properties in Santa Barbara County as a debtor in possession.

The debtor and USB have largely ignored the S.B. Parties on the subject of the cash collateral budget. Indeed, the debtor’s court-ordered Status and Pending Motion Report does not even mention the S.B. Parties’ prior response to the Motions [at ECF 153], even though the S.B. Parties specifically negotiated with the debtor an extension

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<sup>1</sup> Hagen, Treasurer-Tax Collector does not submit to the jurisdiction of this Court for determination of the Debtor’s tax liabilities.

1 of time to file that response. The S.B. Parties were not consulted on the original budget  
2 or any of the various changes in the budget made after the S.B. Parties' response.  
3

4 The S.B. Parties support this debtor having use of cash collateral for purposes  
5 of regulatory compliance, operating under the law, and marketing of the assets on a  
6 going-concern, rather than liquidation, basis. However, the debtor is failing to pay  
7 for the ongoing regulatory costs and property taxes this debtor owes the S.B. Parties  
8 and this cannot continue.  
9

10 In order to preserve and protect the environment and the debtor's assets and  
11 operations, the debtor must pay for all the regulatory health, safety, and environmental  
12 oversight provided by Santa Barbara County and the Santa Barbara County Air  
13 Pollution Control District (APCD). A large portion of the regulation of this oil and  
14 gas company debtor is at the Santa Barbara County level.  
15

16 The debtor incurs numerous ongoing regulatory compliance costs in the  
17 ordinary course of its business. To operate lawfully, the debtor must have and  
18 continue to have permits from numerous departments or divisions of the County,  
19 including, for example  
20

- 21 a. the Energy & Minerals Division which has permit processing fees,  
22
- 23 b. the System Safety & Reliability Review Committee which passes through the  
24 costs the County incurs for consultants to review the debtor's facility safety  
25 plans, perform audits, and perform similar tasks relating to the debtor's  
26 facilities,  
27  
28

- 1 c. the Building & Safety Division which determines fines under the  
2 Administrative Fine Ordinance (County Code, Chapter 24A) when the debtor  
3 does not timely abate its violations, which have been many for this debtor,  
4  
5 d. the Petroleum Division for permits which require additional inspections that  
6 are not included in the annual inspection cycle at the Petroleum Staff's hourly  
7 rate as well as Restoration Accounts for the soil remediation/restoration  
8 activities of this debtor,  
9  
10 e. for Petroleum Ordinance (County Code, Chapter 25) violations,  
11  
12 f. for County Fire Department fees, inspections, and permits for inspecting  
13 leases, wells, pipelines, compressors, offices, buildings and facilities, and tank  
14 batteries,  
15  
16 g. the ongoing Planning & Development Department's (P&D) inspections, fees,  
17 and ongoing regulatory issues, which, for this debtor are very significant, and  
18  
19 h. for Santa Barbara Environmental Health/CUPA, which has regulatory  
20 authority over the debtor's hazardous materials.

21 Just as an example, the debtor was required to pay \$157,812 to SB P&D in advance  
22 for Annual Well & Tank fees for 2019 but failed to pay. The County has nevertheless  
23 continued inspecting the debtor's approximately 756 facilities, and there are about  
24 500 inspections left to perform this year.  
25

26 In addition, the debtor must comply APCD's inspections and regulations. This  
27 includes permit fees for permit renewals, three-year reevaluations under Rule 201.G,  
28

1 NSR permits, and Reimbursable Staff Labor, Air Quality Planning Fees, including  
2 Annual Emissions, Air Toxics, and AQAP fees, Notices of Violation Penalties. This  
3 debtor has 41 active, unresolved NOV's with APCD alone, plus there are 50 open  
4 NOV's with the County. Even when this debtor reaches a settlement on NOV's (*see*  
5 examples attached as **Exhibit A**), it often fails to perform.  
6

7  
8 This debtor and UBS are well-aware that regulatory compliance costs are  
9 administrative expenses that must be paid if this debtor is to continue to operate in  
10 bankruptcy. Each of the many County of Santa Barbara Notices of Violation issued  
11 to this debtor clearly informs the debtor that  
12

13 The Santa Barbara County Petroleum Code, Chapter 25, among other  
14 things, protects the health, safety, public welfare, physical environment  
15 and natural resources of the county by the reasonable regulation of  
16 onshore petroleum facilities and operations, including but not limited to:  
17 exploration; production; storage; processing; transportation; disposal;  
18 plugging and abandonment of wells; and of operations and equipment  
19 accessory and incidental thereto.

20 This debtor did include some line items in its cash collateral budgets for payment of  
21 County and APCD regulatory costs. Perplexingly, however, even though there are  
22 budgeted monies to be spent for regulatory compliance costs, this debtor did not pay  
23 those budgeted amounts.

24 Below is a table of the amounts budgeted by the debtor and court-approved  
25 which appear<sup>2</sup> to be payable to the County and APCD through week 8 (ending today)  
26

27  
28 <sup>2</sup> The budget line item names do not match up to County departments, so it is  
possible that some of these line items are not for payment to the County.

per the Interim Order on cash collateral (ECF 43) and then the two-week bridge Order (ECF 182)

	Week 1 29-Jul-19	Week 2 5-Aug-19	Week 3 12-Aug-19	Week 4 19-Aug-19	Week 5 26-Aug-19	Week 6 2-Sep-19	Week 7 9-Sep-19	Week 8 16-Sep-19	Total through Week 8
Weed Abatement		5,000	5,000	5,000	5,000	5,268	10,000	10,268	45,536
Well Analysis			3,000	3,478	3,000	3,000	3,000	3,000	18,478
Compliance (ALG)			4,723	38,463			10,000	10,000	63,186
Fire Department				36,730		5,000	36,730		78,460
EHS CUPA		8,509							8,509
APCD		4,211	2,000	2,000	60,000	2,000	62,000	2,000	134,211
Settlement Agreement				29,500				29,500	59,000
Total		17,720	14,723	115,171	68,000	15,268	121,730	54,768	407,380

To the knowledge of the County and APCD, none of those amounts were paid, so the debtor is already \$407,380 in arrears<sup>3</sup> of what the debtor itself promised to pay for post-petition regulatory costs to the S.B. Parties.

The budgeted amounts will not cover the ongoing regulatory costs of this debtor. For example, the unpaid compliance costs of this debtor with APCD for the 2019-2020 budget year are approximately \$162,488 for reevaluations and \$45,000 for

<sup>3</sup> \$134,211 for APCD and \$273,169 for County = \$407,380.

1 fees (AQAP, annual emission fees, source test fees, etc.), not even counting the  
2 penalty assessments for Notices of Violations. This debtor's annual penalty  
3 assessments with APCD alone average \$91,474.20 per year over the prior five fiscal  
4 years, but, significantly, those penalty assessments have recently been much higher  
5 than the average; to-wit, \$163,250 (FY 2018-19) and \$160,000 (FY 2017-18) in the  
6 immediate past two fiscal years.  
7

8  
9 Notwithstanding the foregoing, if the \$407,380 total in the foregoing table is  
10 all payable to the County and APCD, and if the debtor were to pay to the County and  
11 APCD the \$407,380 already budgeted and approved and then pay the same amounts  
12 in each of the following 8-week periods of this case, then that would be satisfactory  
13 for the County and APCD to continue their regulatory oversight services, though it  
14 would not address the ongoing taxes owed, which are discussed below. If the  
15 \$407,380 is not all payable to the County and APCD, then this debtor needs to include  
16 all County and APCD obligations in its budget.  
17  
18  
19

20 The Court needs to understand that this debtor has an entirely unacceptable  
21 history of non-compliance. The outstanding unpaid prepetition obligations of the  
22 debtor to the S.B. Parties, not including all penalties and interest, are  
23

S.B. Party	Per S.B. Parties	Per Debtor's Schedules
APCD	\$1,701,344.67	\$145,681.43 plus \$7,867.00 plus "unknown" [actually it is a \$99,000 judgment entered against the debtor on July 16, 2019 in Santa Barbara Superior Court Case No.

		19CV01372. Copy attached as <b>Exhibit B]</b>
SB P&D	\$891,840.60 (as of August 1, 2019)	\$16,627.11 plus \$703,708.05
SB Fire and EHS	\$40,126.00 plus \$7,992.50	\$1,469 plus \$353 plus \$15,114.99
SB Flood Control		\$245
SB County Clerk		\$57
SB Franchise Fees	\$20,200.87	
Harry E. Hagen, Treasurer- Tax Collector	\$4,759,786.96 (as of August 1, 2019)	\$4,654,443.79
<b>Totals</b>	<b>\$7,421,291.60</b>	<b>\$5,644,566.37 plus unknown</b>

This pattern of not paying for environmental, health, and safety regulation or any County services should not be permitted to continue post-petition. These \$7,421,291.60 in regulatory and tax debts have built up over more than a year. Meanwhile, in the past year alone, the Statement of Financial Affairs signed by Randeep Grewal [ECF 171 at 294-296 of 316] shows that, instead of paying the S.B. Parties, the debtor has made at least the following payments to insiders/affiliates:

<b>Insider</b>	<b>Payment</b>
GLR, LLC	\$112,500
GLR, LLC	Transfer of lease
GRL, LLC	\$330,346
GRL, LLC	Transfer of lease
Greka Construction, LLC	\$108,000
GTL1, LLC	\$1,808,000



GIT, Inc.	\$2,292,000
California Asphalt Production, Inc.	\$7,176,390
<b>Total</b>	<b>\$11,827,236 plus lease transfers</b>

This debtor operates its oil and gas business utilizing numerous non-debtor affiliates, such as GCL1, LLC, GTL1, LLC, GRL, LLC, Greka Construction, LLC, GLR, LLC, GSR, LLC, Glnv, Inc., and California Asphalt Production, Inc. (CAP).<sup>4</sup> Those affiliates, such as CAP, are not paying their safety and environmental costs, their Notices of Violation, or their ad valorem taxes, either. Just as examples, CAP owes \$127,584.41 to APCD alone, and Greka Land Holdings, LLC, CAP, and GSR, LLC collectively owe \$628,935.87 in back property taxes.

Not only are the past and ongoing regulatory costs entitled to administrative expense treatment in this bankruptcy case under § 503(b), but they can become liens against the debtor's assets under Santa Barbara County Code § 24A-8.

The stated purpose of the debtor's use of cash collateral is for the debtor to be able to have a reasonable opportunity to reorganize and to maintain the integrity of the debtor's assets and the debtor's asset values. Regulatory compliance by the debtor preserves and enhances the value of the debtor's assets pledged as collateral to the debtor's lender -- UBS. This debtor has announced that it desires to sell assets and

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<sup>4</sup> See *Pereira v. Grecolas Ltd. (In re Saba Enterprises)*, 421 B.R. 626 (Bankr. S.D.N.Y. 2009)(opinion regarding trustee action for fraudulent transfers among some of these same affiliates).

1 pay off its UBS debt. However, this debtor cannot continue to operate without funding  
2 the regulatory oversight needed for safe operations. The County and APCD cannot  
3 continue providing that regulatory oversight for free.  
4

5 The County and APCD have spent many employee hours trying to work with  
6 this debtor on getting its compliance costs brought up to date. Agreements have been  
7 negotiated and entered into, only to be breached by this debtor. *See*, for example,  
8 documents attached as **Exhibit C** and **Exhibit D**. The County and APCD need  
9 assurances that this debtor will fund the safe operations of its facilities. Santa Barbara  
10 County Code § 25-14 states in relevant part  
11  
12

13 The petroleum administrator shall have the primary responsibility for  
14 enforcing the provisions of this chapter. In the event the petroleum  
15 administrator is unable to obtain compliance with any of the terms and  
16 provisions of this chapter, or of any resolution of the board of supervisors  
17 adopted pursuant thereto, he/she may order immediate cessation of  
18 operations.

19 The County's preference is that the debtor voluntarily come into compliance, but it is  
20 not clear the debtor shares that intent.  
21

22 Use of cash collateral to pay for regulatory compliance costs preserves and  
23 enhances the value of UBS's collateral. There is no escaping the taxes and regulatory  
24 costs. If the automatic stay were lifted for UBS to foreclose on its collateral, then that  
25 collateral would still be subject to the superior tax liens and UBS would be incurring  
26 all of the regulatory costs that the S.B. Parties are requesting be included in the budget.  
27 For these reasons, it is appropriate to surcharge UBS's collateral with these costs.  
28

1 This debtor has not been paying its ad valorem taxes. As shown from its  
2 schedules, the debtor was in arrears on ad valorem taxes owed to Harry E. Hagen,  
3 Treasurer-Tax Collector of the County of Santa Barbara in the amount of  
4 \$4,654,443.79 on the petition date. The actual total per the Treasurer-Tax Collector  
5 is \$4,759,786.96 as of August 1, 2019.  
6

7  
8 Additionally, as of January 1, 2019, the debtor incurred the 2019 taxes as a lien  
9 on the debtor's property. Those 2019 taxes are in the approximate amount of  
10 \$696,556.64, which has not yet been billed. The debtor's budgets do not contain any  
11 line items for payment of any of these taxes. [ECF 43 and ECF 182]. To pay down  
12 the debtor's current and back taxes over a lengthy 52-week period, the debtor would  
13 have to budget and pay \$104,929.68 every week ( $\$4,759,786.96 + \$696,556.64 =$   
14  $\$5,456,343.60 \div 52 = \$104,929.68$ ). The debtor has been treating itself as a tax-free  
15 business at the expense of the taxpayers of Santa Barbara County.  
16  
17

18 The debtor asserts that it owes the County \$1,303,358.37 for what the debtor  
19 calls "secured claim" taxes and \$3,351,085.42 for "unsecured claim" taxes, for a total  
20 of \$4,654,443.79. [ECF 1 at 6, 15]. As discussed below, the debtor is wrong. The  
21 County has priority lien status afforded to property assessed on the secured roll for  
22 nearly all of these taxes.  
23  
24  
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28

## Arguments and Authorities

Santa Barbara County is a political subdivision of the State of California which possesses the authority to assess and collect ad valorem taxes on real and personal property. Cal. Rev. & Tax. Code § 121. A debtor in possession must pay its ad valorem taxes. *In re Gifaldi*, 207 B.R. 54, 56 (Bankr. W.D.N.Y. 1997); *In re United Refuse LLC*, 2007 Bankr. LEXIS 1974 \*86-87 (Bankr. E.D. Va. 2007)(“Taxing authorities are no different than any other administrative expense creditor whose claim is incurred in the ordinary course of the debtor’s business, except that they are not optional. They arise simply because the debtor is operating its business. They have always been treated as administrative expenses to be paid in the ordinary course of business.”); *Schechter v. Dept. of Revenue (In re Markos Gurnee P’ship)*, 182 B.R. 211, 227 (Bankr. N.D. Ill. 1995)(“taxes incurred by the estate are an administrative expense”).

Such taxes are a proper expense of administration. Indeed, the debtors were obliged to pay the real estate taxes as they became due and owing. Section 959(b) of Title 28 mandates that a debtor-in-possession ‘manage and operate the property in his possession ... according to the requirements of the valid laws of the State in which such property is situated.’ Having assumed the role of trustee, the debtors held the status of agents conducting business under authority of a United States Court. Under the provisions of 28 U.S.C. § 960, the Gifaldis were, therefore, ‘subject to all Federal, State and local taxes applicable to such business to the same extent as if it were conducted by an individual or corporation.’

*In re Gifaldi, supra.* In *Gifaldi*, a lender had a prior lien on the debtor’s real estate. *Id.* at 55. The cash collateral order provided that the debtor could only pay normal

1 and usual expenses and any payments above \$1,000 had to first be approved by the  
2 lender. *Id.* Without the consent of the lender, the debtor used cash collateral to pay  
3 \$212,683.26 on account of post-petition real estate taxes. *Id.* at 56. The lender was  
4 under-secured and was entitled to adequate protection in the monies paid to the taxing  
5 authorities. *Id.* at 56. However, the court held

6  
7  
8 Lennar correctly notes that it was entitled to receive adequate protection  
9 of its interest in the mortgage. The issue is whether that adequate  
10 protection should extend to payments that the taxing authorities have  
11 received. As to this question, Lennar urges reliance on 11 U.S.C. §  
12 361(3), which states that adequate protection includes such other relief  
13 ‘as will result in the realization of the indubitable equivalent of such  
14 entity’s interest in such property.’ The difficulty with Lennar’s argument  
15 is that a reallocation of payments would assure not an indubitable  
16 equivalent, but a position of superior value. Notwithstanding the failure  
17 of the cash collateral order to authorize payment of post-petition [\*57]  
18 taxes, such obligations are properly chargeable to the secured creditor  
19 pursuant to section 506(c) of the Bankruptcy Code. It provides that ‘the  
20 trustee may recover from property securing an allowed secured claim the  
21 reasonable, necessary costs and expenses of preserving ... such property  
22 to the extent of any benefit to the holder of such claim.’ Even when post-  
23 petition taxes do not give rise to a real estate lien, they do represent a  
24 reasonable and necessary expense for that property. Real property taxes  
are presumed to constitute payment for benefits rendered to the real  
estate. Otherwise, they would create administrative liabilities that would  
survive the disposition of the property. Because these taxes are properly  
chargeable to the mortgagee under section 506(c), Lennar’s interest is  
subject to that potential claim. A reallocation of tax payments seeks,  
therefore, to give Lennar something greater than the indubitable  
equivalent of an interest that would be subject to payment of post-  
petition taxes.

25 *Id.* at 56-57; see also *Harold & Williams Dev. Co. v. Crestar Bank (In re Harold &*  
26 *Williams Dev. Co.)*, 163 B.R. 77, 80-81 (Bankr. E.D. Va. 1994)(despite free and clear  
27 terms of 363 sale, bank ordered to disgorge proceeds of sale to pay city taxes). Thus,  
28

1 the debtor must pay its ad valorem taxes, whether or not they are in the budget as they  
2 should be, and the debtor has the right to surcharge UBS's collateral for such tax  
3 payments. *See Equibank, N.A. v. Wheeling-Pittsburgh Steel Corp.*, 884 F.2d 80, 86  
4 (3<sup>rd</sup> Cir. 1989)(taxes must be paid as administrative expenses and may also be paid as  
5 a surcharge under 506(c)). There is no basis for not including the County taxes in the  
6 cash collateral order budget and requiring that they be paid.  
7

8  
9 The debtor, and perhaps UBS also, is also under the mistaken belief that some  
10 of the ad valorem taxes owed to the County are "unsecured." They are not. All but  
11 \$18,155.90 of the \$4,759,786.96 taxes for prior years were assessed on the "secured  
12 roll." A portion of these secured taxes were moved to the "unsecured roll" solely in  
13 order to initiate collection against HVI Cat Canyon, Inc. as opposed to foreclosing the  
14 lien against the property itself at that time. In no way did this eliminate the County's  
15 tax lien against the debtor's property. *Barer v. County of Riverside*, (1997) 57 Cal.  
16 App. 4<sup>th</sup> 558 [67 Cal. Rptr. 2d 241], pet. review denied, 1997 Cal. LEXIS 8292 (Cal.  
17 1997). In *Barer*, as in this case, taxes were assessed on the secured roll then, after the  
18 taxes became delinquent, they were transferred to the unsecured roll for collection.  
19  
20 *Id.* at 561. Quoting from California Revenue and Tax Code § 107, the court stated  
21  
22

23  
24 Leasehold estates for the production of gas, petroleum and other  
25 hydrocarbon substances... are sufficient security for the taxes levied  
26 thereon. These estates and rights shall not be classified as possessory  
27 interests, but shall be placed on the secured roll. If the tax on any  
28 possessory interest or leasehold estate for the production of gas,  
petroleum and other hydrocarbon substances is unpaid when any  
installment of secured taxes becomes delinquent, the tax collector may

1 use those collection procedures which are available for collection of  
2 assessments on the unsecured roll. [P] If the tax on any possessory  
3 interest or leasehold estate for the production of gas, petroleum and other  
4 hydrocarbon substances remains unpaid at the time set for the declaration  
5 of default for taxes carried on the secured roll, the possessory interest tax  
6 together with any penalty and costs which may be accrued thereon while  
7 on the secured roll shall be transferred to the unsecured roll.

8 *Id.* at n.2. Transferring the delinquent taxes to the unsecured roll is not a transfer of  
9 the assessment of those taxes. *See id.* at 561.

10 In *Barer*, a bank foreclosed on the property after the delinquent taxes were  
11 moved to the unsecured roll for collection, and then the buyer from the foreclosure  
12 sold to another buyer with no knowledge of any prior tax lien. *Id.* at 562. There were  
13 no exceptions in the title commitment or policy “because the title company believed  
14 (mistakenly) that the liens had been eliminated by the foreclosure sale.” *Id.* The buyer  
15 filed an action for declaratory judgment that the property was free and clear of any  
16 tax liens asserting that “when he purchased the property, such purported tax liens were  
17 not shown on the secured rolls where real property taxes were shown and therefore  
18 he was a bona fide purchaser for value.” *Id.* at 562-63. The County and the buyer  
19 filed cross motions for summary judgment. The trial court entered judgment for the  
20 County on the basis that (a) § 107 forced the County to transfer secured delinquent  
21 taxes to the unsecured roll for collection, (b) “Barer had an obligation to search the  
22 prior years’ secured and unsecured rolls to determine what, if any, delinquent taxes  
23 were due against the subject property,” (c) the “tax liens have priority over all other  
24 liens regardless of the time of their creation,” (d) “although Barer did not have actual

1 notice of the delinquent taxes at the time he [Barer] purchased the subject property,  
2 he [Barer] was on constructive notice of the delinquencies based upon his obligation  
3 to conduct such a search of the secured and unsecured rolls,” (e) “although the  
4 delinquent taxes did not show on the current secured roll for 1994 when Barer  
5 purchased the property, it was Barer’s obligation as a matter of law to search prior  
6 years’ secured and unsecured rolls for real property tax delinquencies,” and (f) “as a  
7 matter of law, the non-judicial foreclosure sale conducted under the First Fidelity  
8 Deed of Trust did not eliminate or wipe out the 1991-92 and 1992-93 delinquent real  
9 property tax liens on the subject property.” *Id.* at 565-66.

13 The court of appeals affirmed the *Barer* trial court’s decision on all grounds.  
14 *Id.* at 573. Barer argued that it is extremely difficult for the general public to search  
15 both the secured and unsecured tax rolls, but the court pointed out that the lender had  
16 the capacity to do that and, regardless of difficulty, “plaintiff’s contention that he  
17 should not be required to search such indexes is without merit.” *Id.* at 573. “Generally  
18 the Legislature is supreme in the field of taxation.” *Id.* at 571. The court noted that  
19 “section 2192.1 provides that ‘[e]very tax declared in this chapter to be a lien on real  
20 property ... has priority over all other liens on the property, *regardless of the time of*  
21 *their creation.*’” *Id.* at 566 (emphasis in original). The procedure for assessing taxes  
22 on oil and gas interests as secured property taxes are separable from the proceedings  
23 for collecting the taxes. *Id.* at 570, citing *Picchi v. Montgomery* (1968) 261 Cal. App.  
24 2d 246, 253 [67 Cal. Rptr. 880].



1 The \$4,759,786.96 of unpaid prepetition ad valorem taxes will have to be paid  
2 along with the 2019 taxes of approximately \$696,556.64 and future taxes. Indeed, the  
3 post-petition taxes of this debtor constitute both secured claims as well as  
4 administrative priority claims. *In re Soltan*, 234 B.R. 260, 272-73 (Bankr E.D.N.Y.  
5 1999). To amortize the prepetition taxes of \$4,759,786.96 over a six-month (26-week)  
6 period, and not including penalties and interest, would require payments of  
7 \$183,068.72 per week. To pay the 2019 post-petition taxes of \$628,935.87 over a  
8 six-month (26-week) period, and not including penalties and interest, would require  
9 payments of \$24,189.84 per week. But nothing is in the budget for payment of any  
10 taxes, pre- or post-petition.  
11

12 Payment of taxes is an ordinary part of a debtor in possession's business and  
13 requires no notice or court approval. 11 U.S.C. § 363(c)(1). The failure to pay taxes  
14 is a basis for conversion to chapter 7. 11 U.S.C. § 1112(b)(4)(I); *In re Builders Group*  
15 & *Dev. Corp.*, 2014 WL 1873412, 2014 Bankr. LEXIS 2092 \*22 (Bankr. D. P.R.  
16 2014).

17 Harry E. Hagen, Treasurer-Tax Collector does not consent, under 11 U.S.C.  
18 363(c)(2)(A) or otherwise, to any interim or final cash collateral orders that do not  
19 provide for the payment of the taxes owed to the County. The past, current, and future  
20 taxes owed to the County are liens which cannot be avoided or delayed by the debtor's  
21 bankruptcy. 11 U.S.C. § 362(b)(18), § 503(b), § 546(b), and § 547(c)(6). The cash  
22 collateral orders should provide for the payment of the taxes and make clear that the  
23  
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28

1 taxes are a first lien on the debtor's property in Santa Barbara County under Cal. Rev.  
2 & Tax. Code § 2192.1 and that this will continue for future years' taxes. If UBS were  
3 entitled to any adequate protection lien, which is disputed because UBS is over-  
4 secured, UBS would not be entitled to any adequate protection lien that would put  
5 UBS ahead of the County.  
6

7  
8 Trustees and debtors in possession must, of course, comply with all laws and  
9 regulations as they operate, whether in chapter 11 or chapter 7. *See* 28 U.S.C. §§ 959,  
10 960. Oil and gas operators who operate as debtors in possession must comply with  
11 the laws and regulations governing their operations. *Texas v. Lowe (In re H.L.S.*  
12 *Energy Co.)*, 151 F.3d 434 (5<sup>th</sup> Cir. 1998)(plugging and abandonment obligations  
13 owed to state agency were administrative expenses of the estate); *Munce's Superior*  
14 *Petroleum Prods. v. N.H. Dep't of Env'tl. Services (In re Munce's Superior Petr.*  
15 *Prods)*, 736 F.3d 567, 571-73 (1<sup>st</sup> Cir. 2013)(post-petition state agency fines of \$1,000  
16 per day against debtor for non-compliance with environmental law which began  
17 prepetition but continued post-petition were given administrative expense treatment);  
18 *In re Am. Coastal Energy, Inc.*, 399 B.R. 805, 816 (Bankr. S.D. Tex. 2009)(awarding  
19 administrative expense treatment of state agency costs against oil and gas debtor and  
20 stating "[a] debtor cannot operate an estate in violation of environmental and safety  
21 laws."). Compliance with regulations is considered a benefit to the estate for purposes  
22 of 11 U.S.C. § 503(b) even if compliance means the cost of plugging old oil wells for  
23 environmental reasons. *Texas v. Lowe* at 436-439. Not paying sales taxes and thereby  
24  
25  
26  
27  
28

1 subjecting the debtor to interest charges by the taxing authority results in the interest  
2 charges being treated as administrative expenses. *Id.* at 438.

3  
4 Even if the automatic stay were lifted for UBS to foreclose on the debtor's  
5 properties, UBS would be incurring all of the regulatory costs and taxes that should  
6 be paid under the cash collateral orders and budgets.

7  
8 The debtor cannot avoid the prepetition unpaid regulatory oversight costs. For  
9 example, California Government Code § 54988 provides governmental units such as  
10 Santa Barbara County with the right to make unpaid regulatory costs a lien against  
11 the debtor's property which "may be collected at the same time and in the same  
12 manner as property taxes are collected." As set forth above, this debtor owes at least  
13 \$2,661,504.64 ( $\$7,421,291.60 - \$4,759,786.96 = \$2,661,504.64$ )<sup>5</sup> in prepetition  
14 regulatory costs, in addition to this debtor's unpaid property taxes.

15  
16  
17 The S.B. Parties do not support the granting of any lien on estate avoidance  
18 actions. Those actions must be preserved for unsecured creditors. *See In re Ludford*  
19 *Fruit Products, Inc.*, 99 B.R. 18, 25 (Bankr. C.D. Cal. 1989)(giving prepetition  
20 secured creditor a lien on avoidance actions would violate logic and the policy behind  
21 the avoidance powers); *In re Kooh, LLC*, 2010 Bankr LEXIS 5992 \*9-10 (Bankr.  
22 N.D. Tex. 2010)(cash collateral order excepted chapter 5 causes of action from  
23  
24  
25  
26

27 <sup>5</sup> Per table in the Facts section. In the same table, the debtor's incorrect number is  
28 \$990,122.58 in prepetition regulatory costs owed ( $\$5,644,566.37 - \$4,654,443.79 =$   
\$990,122.58)

1 replacement lien and made replacement liens inferior to the liens of ad valorem taxing  
2 authorities).

3  
4 **Conclusion**

5 The budgets that the debtor and UBS attached to the interim [ECF 43] and  
6 bridge [ECF 182] cash collateral orders are fatally flawed in that they do not authorize  
7 the debtor to pay its property taxes. The budgets do appear to provide for regulatory  
8 oversight costs to the County and APCD; however, the debtor has refused to make  
9 the payments. The taxes and regulatory costs must be included in the budget and paid  
10 or this case will need to be converted and the regulators will need to order cessation  
11 of all operations in the County. The S.B. Parties seek such other relief to which they  
12 are entitled.

13  
14  
15  
16 Dated: September 19, 2019

SNOW SPENCE GREEN LLP

17 By: /s/ Ross Spence

18 Ross Spence  
19 Pro Hac Vice Pending

20  
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23 *Tax Collector of the County of Santa*  
24 *Barbara, California; and Santa Barbara Air*  
25 *Pollution Control District*